IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 521

GENERAL ELECTRIC COMPANY, *Petitioner*,

v.

THE UNITED STATES.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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Petitioner, the General Electric Company, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Claims in this case.

OPINION BELOW

The opinion below (Appendix, *infra,* pp. A-1-48) has not yet been officially reported; it is reported at 299 F. 2d 942, but without the findings of fact of the court below.

JURISDICTION

The judgment of the Court of Claims was entered on March 7, 1962 (R. 39;[1] Appendix, *infra*, p. A-1). Thereafter, on April 6, 1962, the Court of Claims extended the time within which plaintiff could file a motion for rehearing until May 6, 1962 (R. 80). Such motion was filed on April 26, 1962, and was denied by the Court of Claims on July 18, 1962 (R. 80). The jurisdiction of this Court is invoked under 62 Stat. 928 (1948), 28 U.S.C. § 1255 (1).

QUESTION PRESENTED

Whether or not petitioner corporation during the years 1949 through 1953 realized gain or loss for income tax purposes under the Internal Revenue Code of 1939 from certain dispositions of shares of its own stock which were carried as treasury stock and were used strictly for intracorporate purposes.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939, § 22, 53 Stat. 574 (1939), 26 U.S.C. § 22 (1939).

"Sec. 22. Gross Income.

"(a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or

[1] The reference is to the certified transcript of record.

personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

Treasury Regulations 111 (promulgated under the Internal Revenue Code of 1939).

"Sec. 29.22(a)-15. Acquisition or Disposition by a Corporation of Its Own Capital Stock.—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

"But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code."

Section 39.22(a)-15 of Treasury Regulations 118 (promulgated under the Internal Revenue Code of

1939) applicable to the years 1952 and 1953 is to the extent material herein identical to section 29.22(a)-15 of Treasury Regulations 111.

STATEMENT OF THE CASE

The pertinent facts, as found by the Court of Claims (R. 51-79; Appendix, *infra*, pp. A-15-48) may be summarized as follows:

Petitioner is a New York corporation and from January 1, 1936, through 1953 had 28,845,927 36/100 shares of its no par value common stock issued and outstanding. Its stock was listed and traded on the New York Stock Exchange. (R. 51-52; Appendix, *infra*, pp. A-15, 17)

During the years 1949 through 1953 petitioner used shares of its own common stock carried in its treasury to implement two employee plans. (R. 57-61, 63-66; Appendix, *infra*, pp. A-22-27, 30-33) Under one of these plans petitioner compensated employees in important and supervisory positions at approximately the same time each year by payments partly in cash and partly in shares of petitioner's stock.[2] (R. 61; Appendix, *infra*, pp. A-26-27) This plan had been in effect for many years. (R. 57; Appendix, *infra*, pp. A-22-23) Under the other plan,[3] established in 1948, petitioner, to encourage savings by the employees, contributed shares of its own stock to a trust for the benefit of its employees who purchased U. S. Savings Bonds, Series E, and left such bonds in petitioner's custody for about five

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[2] The name of this plan is the Extra or Incentive Compensation Plan. (R. 60; Appendix, *infra*, p. A-26)

[3] The name of the second plan is the G. E. Employees Savings and Stock Bonus Plan. (R. 63; Appendix, *infra*, p. A-30)

years. At the end of such period such employees received their bonds plus shares of petitioner's stock equal to 15 per cent of the cost of the bonds. (R. 63-64; Appendix, *infra*, pp. A-30-31)

One of the petitioner's objectives in using treasury stock under these two plans was to give its employees a continuing stake in the future financial success of their company. Petitioner never used stock of another corporation under either plan and never considered doing so. (R. 63, 65; Appendix, *infra*, pp. A-29, 32) The ownership of the stock in the hands of the employees was not restricted since petitioner's stock was widely held and control was not a factor. (R. 63; Appendix, *infra*, pp. A-29-30) On its tax returns for the years 1949 through 1953 petitioner claimed and was allowed deductions equal to the fair market value of the shares of its treasury stock distributed to such employees or contributed to the trust. (R. 78; Appendix, *infra*, pp. A-47-48)

These two plans accounted for the great bulk of petitioner's distributions of shares of its own stock during the years here in issue.[4] In all petitioner used more than 500,000 shares of its common stock for all purposes during the 1949-1953 period. (R. 77; Appendix, *infra*, p. A-46)

The shares of petitioner's stock used as described above with minor exceptions came from two sources only: as distributions from a wholly-owned subsidiary corporation, G. E. Employees Securities Corporation (hereinafter called "Employees Securities")

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[4] The other distributions or dispositions are set forth in the findings of the court below. (R. 61, 66-70; Appendix, *infra*, pp. A-27, 33-37)

and from open market purchases. (R. 71-72; Appendix, *infra*, pp. A-39-40) Employees Securities was a regulated investment company organized by petitioner in 1923 to provide a medium for the investment of savings of petitioner's employees. Petitioner supplied all the equity capital and owned all the stock. (R. 52; Appendix, *infra*, p. A-17) From the inception it was contemplated that at least 25 per cent of its assets would consist of petitioner's stock. This was to give the investing employees an indirect interest in the company for which they worked. (R. 53; Appendix, *infra*, p. A-18) By 1948 the corporate purpose of Employees Securities could no longer be carried out and it was liquidated that year. The presence of petitioner's shares in Employees Securities did not influence the decision to liquidate that corporation. (R. 55-56; Appendix, *infra*, pp. A-20-21) Its holdings of petitioner's stock had remained relatively constant over the years and had materially increased in value. (R. 54; Appendix, *infra*, p. A-19) Petitioner, upon such liquidation, received 475,800 shares of its own common stock along with other property. (R. 56; Appendix, *infra*, p. A-21) No gain or loss was recognized upon such liquidation by virtue of the provisions of section 112(b)(6) of the Internal Revenue Code of 1939, 52 Stat. 485, 26 U.S.C. § 112(b)(6). (R. 77; Appendix, *infra*, p. A-46)

Petitioner made open market purchases of shares of its own stock in 1951, 1952 and 1953. These were geared to petitioner's estimated needs for its stock for use under the employee plans described above and for other corporate purposes. (R. 72-73; Appendix, *infra*, pp. A-40-41)

All of petitioner's stock when reacquired was held by it in its treasury. (R. 72; Appendix, *infra*, p. A-41) It carried no voting rights and no dividends were paid thereon. (R. 76; Appendix, *infra*, p. A-44) As to both the acquisitions and dispositions of treasury stock the Court of Claims found:

> "On the basis of the whole record, it is evident that the timing of plaintiff's acquisitions and dispositions of its own stock, in carrying out the various employee plans and other corporate operations described in these findings, was related to fulfillment of the requirements and objectives of such plans and other corporate operations." [R. 77; Appendix, *infra*, p. A-46]

There is no evidence petitioner ever sold shares of its treasury stock on the open market. (R. 70; Appendix, *infra*, p. A-38)

For each of the years 1949 through 1953 petitioner paid a tax on the difference between the cost or other basis of the treasury stock disposed of in each year and the fair market value of the shares at the time of disposition. (R. 77; Appendix, *infra*, p. A-46) After the rejection of its timely claims for refund petitioner brought this suit in the court below pursuant to 62 Stat. 940 (1948), 28 U.S.C. § 1491. (R. 51, 79; Appendix, *infra*, pp. A-15, 48) The Court of Claims held petitioner was taxable on such difference and dismissed petitioner's petition. (R. 79; Appendix, *infra*, p. A-48)

REASONS FOR GRANTING THE WRIT

The writ should be granted because the Court of Claims has decided a federal question in a way in conflict with the decision of this Court in *United States* v. *Anderson, Clayton & Co.*, 350 U.S. 55 (1955). In effect, the Court of Claims disregarded this Court's decision. As a result an area of conflict which had been set to rest by this Court has been revived and new uncertainties have been introduced.

1. This Court's Decision in Anderson, Clayton Established the Profit-Motive Test as the Proper Interpretation of the Regulations

In *United States* v. *Anderson, Clayton & Co., supra*, a corporation, pursuant to an agreement with its stockholders, had bought the shares of a deceased stockholder from his estate and had later sold some at an increased price to junior officials in recognition of their responsibilities and worth. The Government took the position that taxable income was realized by the corporation on the sale, despite the fact that, under the regulations applicable in that case, as in this one (quoted *supra*, p. 3), a corporation realizes taxable income only if it "deals in its own shares as it might in the shares of another corporation".

The Tax Court of the United States had consistently held that corporations in comparable circumstances had not dealt in their own shares as they might in the shares of other corporations and therefore realized no taxable income. However, with equal consistency the Courts of Appeals had reversed on the theory that the resale of treasury shares at a price greater than cost always results in a taxable gain, holding in effect that the only disposition of

treasury stock that could avoid the realization of gain or loss was retirement.[5] The Court of Claims in *Anderson, Clayton & Co.* v. *United States*, 129 C. Cls. 295 (1954), disagreed with the Courts of Appeals and held that taxable gain had not been realized.

To resolve the resulting conflict this Court granted certiorari, 348 U.S. 936, and affirmed the Court of Claims, 350 U.S. 55. In its opinion, this Court pointed to the absence of "any shown purpose of advantageous investment" (350 U.S. 55, 59) or of consideration given to the opportune time for the purchase or sale of the treasury stock. It emphasized that treasury stock on which no dividends were paid, which is not voted or taken into account in establishing a quorum, lacks the rights which are incident to ownership of stock in other corporations. All of those facts are also present in this case. In conclusion, this Court stated:

> "* * * When viewed in its entirety, the instant transaction, limited to a wholly intracorporate purpose with no element of speculation or gain envisioned from dealing in its shares, does not constitute dealing by the corporation in its own shares as it might deal in the shares of another corporation within the meaning of the regulation." [350 U.S. 55, 60]

As the Internal Revenue Service itself believed (see Rev. Rul. 60-328, 1960-2 C.B. 427, *infra*, p. 10), this Court thereby established the principle that the sole test of taxability under the treasury stock regulations is whether or not the "transaction [when

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[5] The history of this long conflict has been ably set forth in *Girard Trust Corn Exchange Bank* v. *United States*, 191 F. Supp. 551, 553-554 (E.D. Pa. 1961).

viewed in its entirety, is] limited to a wholly intra-corporate purpose with no element of speculation or gain envisioned from dealing in its shares" (350 U.S. 55, 60). This principle is hereinafter referred to as the profit-motive test.

2. This Court's Profit-Motive Test Was Accepted and Applied Until This Case

This Court's profit-motive test was logical, equitable and relatively easy to apply. There was no suggestion that this Court was adopting a narrow rule of limited application and in fact the profit-motive test has been consistently applied in a variety of factual situations.

In 1960, the Court of Claims in *Hercules Powder Company* v. *United States,* 149 C. Cls. 77, 180 F. Supp. 363 (1960), applying the profit-motive test, held that taxable gain had not resulted from treasury stock transactions which in this case it admitted were "closely alike" to the ones present here. (R. 50; Appendix, *infra,* p. A-14) Soon thereafter, the Internal Revenue Service, revoking its prior position, published Rev. Rul. 60-328, 1960-2 C.B. 427, the official headnote of which is a nearly-verbatim quotation from this Court's *Anderson, Clayton* opinion:

> "Where the acquisition and disposition of treasury stock by a corporation is limited to a wholly intracorporate purpose with no element of speculation or gain envisioned, it does not constitute dealing by the corporation in its own shares as it might deal in the shares of another corporation within the meaning of section 39.22(a)-15 of Regulations 118. No taxable gain will be realized from the sales thereof."

In 1961 in the *Girard Trust Corn Exchange Bank* v. *United States,* 191 F. Supp. 551, the District Court for

the Eastern District of Pennsylvania was persuaded by the Government to apply this Court's profit-motive test and to hold that treasury stock transactions had not resulted in deductible loss. The Government also relied upon the Court of Claims' decision in *Hercules Powder Company, supra*, a decision which it now seeks to repudiate.

Thus, as a result of this Court's decision, the law after years of confusion and conflict among the courts finally appeared settled, until the Court of Claims with changed membership restored the confusion by its decision in this case.

3. The Decision Below Ignored the Profit-Motive Test and Amounts to a Repudiation of This Court's Decision in Anderson, Clayton & Co., 350 U.S. 55, Thus Restoring the Prior Confusion

It is significant that nowhere in the findings of fact of the Court of Claims in this case is there even a suggestion that petitioner had a profit motive in its treasury stock transactions.[6] That court did not even discuss this Court's interpretation of the applicable regulations, let alone attempt to apply it. Instead, the Court of Claims adopted the totally new test of whether petitioner's stock was used as the "equivalent of cash" and concluded that "whether it be in lieu of cash or in lieu of stock in another corporation matters not". (R. 49-50; Appendix, *infra*, p. A-14)

This is therefore not a case of mere error by the court below in applying a test laid down by this Court,

[6] The conjecture of Judge Whitaker in his opinion for the majority (R. 49; Appendix, *infra*, p. A-13) is pure surmise. It is not a finding of fact. See *United States* v. *Wells*, 283 U.S. 102, 120 (1931).

the proper application of which would result in a judgment for petitioner. It amounts to ignoring this Court's rule and thus constitutes a decision of a federal question in a way in conflict with an applicable decision of this Court.

The Court of Claims attempted to justify the use of its novel, equivalent-of-cash test on the ground that petitioner used treasury stock to pay compensation to employees. (R. 50; Appendix, *infra*, p. A-14) While Anderson, Clayton & Co. sold stock to employees, this is not a significant distinction justifying departure from the profit-motive test in this case. Here, as in *Anderson, Clayton*, the crucial fact is that the corporation, without profit motivation, transferred shares of its own stock to employees in order to give them an interest in the business, an intracorporate purpose which obviously could not have been accomplished if shares of another corporation or cash had been used. The Court of Claims expressly found that petitioner had this purpose in using treasury stock. (R. 63, 65; Appendix, *infra*, pp. A-29, 32)

To make confusion worse confounded, the Court of Claims appears now to have discarded its equivalent-of-cash test also. On October 3, 1962 that court decided *Penn-Texas Corporation* v. *United States*, No. 299-58.[7] In that case the taxpayer had used 8,927 shares of treasury stock as part of the consideration for the acquisition of the business and assets of

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[7] Since this case was so recently decided and has not been officially reported, it has for the convenience of the Court been printed as a part of the Appendix to this petition. (Appendix, *infra*, pp. A-49-60)

another corporation.[8] Admittedly, cash could have been so used; so normally the equivalent-of-cash test would have resulted in the taxability of the large gain. Yet the court held that no gain was realized. In doing so it stated:

> "* * * it is not enough to assure taxability that, if the company had desired, cash could have been substituted for the stock, with the same general end-result; that would almost always be true and therefore cannot serve as the cardinal touchstone."[9] [Appendix, *infra*, p. A-54]

But the *Penn-Texas* case does not return to the profit-motive test. Its sole reference to this subject is to the effect that speculative trading is not a prerequisite to taxability, for which it cites *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145, 148 (2d Cir. 1942), *cert. denied* 317 U.S. 681 (1942), making no mention of *Anderson, Clayton* in this connection. It takes the

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[8] It is significant that one of the uses made by petitioner of its treasury stock was to acquire in 1953 stock of another corporation (R. 69; Appendix, *infra*, pp. A-36-37). The Court of Claims made no mention of this transaction as being different from distributions to petitioner's employees.

[9] It is also significant that, although in the petitioner's case the court below made much of the fact that petitioner is entitled to a deduction as an ordinary and necessary business expense for the fair market value of treasury stock transferred as compensation to employees, in its *Penn-Texas* opinion it did not mention this even as a factor of possible importance, despite the lengths to which it went in *Penn-Texas* in describing the rationale of its decision in petitioner's case. Apparently, the court now recognizes that this is no more relevant to the question of whether taxable gain or deductible loss is realized on dispositions of treasury stock than is the question of what use was made of the proceeds of the sales involved in the *Anderson, Clayton* case.

position that there is no test of universal application (Appendix, *infra*, pp. A-53-54), and concludes—

> "We are thus left to weigh all the 'facts and circumstances' * * * on a scale calibrated only with this very general guide: Has the company 'deal[t] in its own shares as it might in the shares of another corporation' (Treas. Reg. 111, § 29.22(a)-15? * * *"

This would leave the outcome of each case to be determined by the inclinations of the judges who happen to be sitting. If this is correct, this Court in *Anderson, Clayton* decided nothing but a narrow factual issue.

In attempting to distinguish this case from *Penn-Texas* the Court of Claims referred to the fact that petitioner had a "continuing program" for use of its shares (Appendix, *infra*, p. A-55). But so did the taxpayer in *Commissioner* v. *Batten, Barton, Durstine & Osborn, Inc.*, 171 F. 2d 474 (2d Cir. 1948), which the Court of Appeals decided in favor of the Government but which this Court rejected in *United States* v. *Anderson, Clayton & Co.*, 350 U.S. 55, 60 (1955).

What is even more relevant to the necessity for certiorari in this case, however, is the admission by the Court of Claims that it does not know the exact bearing of the *Anderson, Clayton* case on the precise issue with which it was confronted in petitioner's case. In *Penn-Texas*, it cited *Commissioner* v. *Air Reduction Co.*, 130 F. 2d 145 (2d Cir. 1942), as being applicable (Appendix, *infra*, p. A-54). Yet in footnote 5 of the opinion (Appendix, *infra*, pp. A-55-56), after describing *Air Reduction Co.* in terms almost identical with what was considered to be the fatal flaw in petitioner's case, it states—

> "* * * It is not clear * * * to what extent this portion of *Air Reduction Co.* has survived *Anderson, Clayton.* G.C.M. 16651, which the Second Circuit specifically noted as dealing with similar sales to corporate officers (130 F. 2d at 148), has been revoked on the basis of *Anderson, Clayton.* See Rev. Rul. 60-328, 1960-2 Cum. Bull. 427."

Under these circumstances, a further statement by this Court of the full import of *Anderson, Clayton* seems regrettably necessary to bring home the fact that it laid down a rule of general application to all treasury stock cases which, when properly applied, must result in a reversal of the decision below in this case.

4. Importance of the Issue

The question presented here is of importance not only to this petitioner and other taxpayers similarly situated,[10] but to the orderly administration of the income tax laws. Is the resolution by this Court of a long-standing conflict between the lower courts, such as occurred in *United States* v. *Anderson, Clayton & Co.,* 350 U.S. 55, to be ignored and a new test or tests of taxability to be adopted depending upon such chance

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[10] Petitioner is reliably informed that at least three substantial, similar cases are pending in the Court of Claims, involving treasury stock transactions under the Internal Revenue Code of 1939. One of these cases is *Hercules Powder Company* v. *United States*, Docket No. 251-61 involving for a later year the identical issue decided for the taxpayer in *Hercules Powder Company* v. *United States*, 149 C. Cls. 77, 180 F. Supp. 363. Petitioner has no way of knowing how many such cases are still pending at the administrative level. Under the 1954 Code, by virtue of section 1032, 68A Stat. 303, 26 U.S.C. § 1032, such transactions have no tax consequences. This section was enacted before this Court granted certiorari in *United States* v. *Anderson, Clayton & Co.,* 348 U.S. 936.

events as changes in the composition of the court below? A conflict once resolved should stay resolved. The profit-motive test adopted by this Court should be applicable to all treasury stock cases arising under the Internal Revenue Code of 1939, not merely to some of them.

CONCLUSION

This petition for a writ of certiorari should be granted.

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